UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

ROBERT A. ROSE, et al.,	***)***	
	)	
Plaintiffs	***)***	
	)	
v.	***)***	***Docket No. 98-5-P-H***
	)	
DAVID E. SHAW, et al.,	***)***	
	)	
Defendants	***)***	

RECOMMENDED DECISION ON DEFENDANTS' MOTION TO DISMISS

The defendants, David E. Shaw, Erwin F. Workman and IDEXX Laboratories Inc. ("IDEXX"), move to dismiss the amended complaint in this purported class action alleging violations of the Securities Exchange Act, 15 U.S.C. § 78a *et seq.*, and its accompanying regulations. I recommend that the court grant the motion in part and deny it in part.[1]

I. Applicable Legal Standard

The motion to dismiss invokes Fed. R. Civ. P. 9(b) and 12(b)(6). "When evaluating a motion to dismiss under Rule 12(b)(6), [the court] take[s] the well-pleaded facts as they appear in the complaint, extending the plaintiff every reasonable inference in [its] favor." *Pihl v. Massachusetts Dep't of Educ.*, 9 F.3d 184, 187 (1st Cir. 1993). The defendant is entitled to dismissal for failure to

[1] The plaintiffs have requested oral argument on the motion. Docket No. 18. I am satisfied that the written submissions of the parties adequately address the issues raised. Therefore, the request for oral argument is denied.

state a claim "only if it clearly appears, according to the facts alleged, that the plaintiff cannot recover on any viable theory." *Correa-Martinez v. Arrillaga-Belendez*, 903 F.2d 49, 52 (1st Cir. 1990); *see also Jackson v. Faber*, 834 F. Supp. 471, 473 (D. Me. 1993). Because the claims raised in the amended complaint in this action are subject to the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737, the defendants contend that the usual standard for motions to dismiss pursuant to Rule 12(b)(6) does not apply. I will discuss this contention in Section III of this recommended decision.

Fed. R. Civ. P. 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." A complaint alleging fraud must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Suna v. Bailey Corp.*, 107 F.3d 64, 68 (1st Cir. 1997) (quoting *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1127-28 (2d Cir. 1994)). A securities plaintiff "must allege specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading." *Id*. (internal quotation marks omitted; brackets in original). Statements made on information and belief do not meet the particularity requirement of Rule 9(b) unless the complaint also pleads facts on which the belief is founded. *In re One Bancorp Sec. Litig.*, 135 F.R.D. 9, 12-13 (D. Me. 1991). Further refinements of this standard by the First Circuit will be discussed in Section III below.

II. Factual Background

The named plaintiffs, Robert A. Rose, James Bergeron, Bruce Chalker, William Wood and

Robert Bergeron, purport to represent a class of plaintiffs who purchased or acquired common stock of defendant IDEXX during the period from July 19, 1996 through March 24, 1997 (the "class period"). Amended Class Action Complaint (Docket No. 11) ¶ 1. The amended complaint makes the following allegations.

Each of the named plaintiffs purchased shares of IDEXX common stock during the class period. *Id.* ¶ 5. Defendant IDEXX is a Delaware corporation with a principal place of business in Westbrook, Maine that makes products used for animal, food and environmental testing. *Id.* ¶ 6. At all relevant times, Defendant Shaw was chairman of the board and chief executive officer of IDEXX and Defendant Workman was its president and chief operating officer. *Id.* ¶ 7. Both were also directors of IDEXX. *Id.* The majority of IDEXX's revenue is generated by the sale of veterinary diagnostic products. *Id.* ¶ 8. IDEXX sells these products primarily through its own employee sales force. *Id.* ¶ 10. IDEXX was founded in 1983. *Id.* ¶ 12.

At an unspecified time, the defendants "loaded" IDEXX's distributors with excess inventory with a value reported to be $15 million in order to continue to report strong growth and fraudulently recognized revenues from purported sales of veterinary products. *Id.* ¶ 13. By March 24, 1997 IDEXX was forced to announce that it would be reducing shipments to distributors and that its sales in the future would be adversely affected as a result. *Id.* Following this announcement IDEXX reported declining revenues and losses. *Id.* Before and during the class period, IDEXX engaged in practices concerning its veterinary products that were designed to artificially inflate its reported operating results. *Id.* ¶¶ 14-20, 22, 27-31, 35-40. The defendants were aware of the rising level of inventory held by IDEXX's distributors. *Id.* ¶¶ 23-24, 26. IDEXX failed to disclose declines in its sales in Europe during 1996. *Id.* ¶¶ 42-43.

IDEXX issued a press release on July 19, 1996 announcing its financial results for the quarter ending June 30, 1996. *Id*. ¶ 44. It filed Securities and Exchange Commission ("SEC") Form 10-Q for the same period on July 26, 1996. *Id*. ¶ 45. Analyst reports based on information provided by IDEXX were published by third parties in August and September 1996. *Id*. ¶¶ 46-47. On or about October 18, 1996 IDEXX issued a press release announcing its financial results for the quarter ending September 30, 1996. *Id*. ¶ 49. On or about November 12, 1996 IDEXX filed a Form 10-Q for the same period. *Id*. ¶ 50. On or about February 14, 1997 IDEXX issued a press release announcing its financial results for the quarter ending December 31, 1996. *Id*. ¶ 52. Analyst reports based on information provided by IDEXX were issued by third parties in March 1997. *Id*. ¶ 54. The plaintiffs contend that each of these documents was materially false and misleading. *Id*. ¶¶ 44-45, 49-53.

On March 24, 1997 IDEXX announced that it expected lower than anticipated revenues and earnings for the first quarter of 1997. *Id*. ¶ 55. The price-per-share of IDEXX stock immediately fell by 63%. *Id*. ¶ 56. By June 23, 1997 the price-per-share had fallen from $32.00 on the day of the announcement to $13.31. *Id*. On or about July 18, 1997 IDEXX issued a press release announcing a net loss for the quarter ending June 30, 1997. *Id*. ¶ 62. On or about October 17, 1997 IDEXX issued a press release announcing a net loss for the quarter ending September 30, 1997. *Id*. ¶ 63(c). IDEXX issued a press release on or about February 12, 1998 announcing a net loss for the quarter ending Decembe4 31, 1997 and for the 1997 fiscal year. *Id*. ¶ 63(e).

Each of the statements by IDEXX alleged to be false and misleading (i) failed to disclose that increased sales of IDEXX products were the result of its "loading" practices; (ii) failed to disclose that distributors' inventories were extremely bloated and that distributors were increasingly reluctant

to accept additional product; (iii) failed to disclose that substantial amounts of short-dated product were in its distribution channels and were being returned in significant amounts; (iv) failed to disclose that its sales and growth rate would decline as a result of its "loading" practices; (v) showed as increased sales a significant number of purported sales that should not have been recognized as revenue; (vi) failed to disclose that 70% of sales of IDEXX veterinary products in any given quarter occurred in the final month of that quarter, when such a pattern is routinely disclosed by other companies; (vii) failed to disclose that IDEXX was accumulating a substantial inventory of diagnostic slides that were significantly dated and therefore of declining value, which distributors were not willing to accept; (viii) failed to disclose that the market for veterinary instruments in the United States was reaching saturation and that IDEXX's sales were declining as a result; (ix) failed to disclose that a significant number of veterinary instruments were being returned to IDEXX, requiring it to reverse the revenue it had recognized on the sale of those instruments; (x) failed to disclose that a canine allergy test product was being sold prematurely; (xi) failed to disclose that canine allergy test kits were being returned and exchanged for canine heartworm test kits and that these product exchanges were cannibalizing sales of canine heartworm test kits; (xii) failed to disclose that IDEXX's European operations were suffering from severe competition requiring IDEXX to slash prices, virtually wiping out its profit margin; (xiii) artificially inflated IDEXX's reported financial results; (xiv) meant that IDEXX's financial statements were not prepared in accordance with generally accepted accounting practices ("GAAP"); (xv) failed to disclose known trends, events or uncertainties that were reasonably expected or likely to have a material unfavorable impact on IDEXX's net income or to result in a material decrease in IDEXX's liquidity; and (xvi) made the defendants' forecasts of earnings per share and growth rate in earnings per share for 1997

false when made and known by the defendants to be false. *Id*. ¶ 64.

IDEXX knew in May 1996 that most of its canine allergy tests would be returned but failed to establish a reserve for those returns in its financial statements as required by GAAP. *Id*. ¶ 79. By the fourth quarter of 1996 IDEXX was experiencing a 20% return rate on the sale of its new instrument products, yet it failed to establish a reserve for those returns, nor did it establish a reserve for its impaired slide inventory. *Id*. ¶¶ 83, 85. IDEXX's practices violated several generally accepted accounting practices and Item 303 of Regulation S-K promulgated by the SEC (17 C.F.R. § 229.303). *Id*. ¶¶ 86-87. The defendants provided materially misleading information about IDEXX to securities analysts at various brokerage houses in order to promote IDEXX stock. *Id*. ¶¶ 88-90, 92-94. The defendants inflated the price of IDEXX stock in order to acquire Idetek Inc. on favorable terms in August 1996. *Id*. ¶ 97. Each of the individual defendants and other IDEXX directors derived benefit from the failures to disclose described above by selling large blocks of IDEXX stock at artificially inflated prices. *Id*. ¶ 100.

At all relevant times, IDEXX common stock was listed and traded on the NASDAQ National Market System. *Id*. ¶ 101.

III. Discussion

In order to state a claim under 15 U.S.C. § 78j(b) ("section 10(b)") and 17 C.F.R. § 240.10b-5 ("Rule 10b-5"), the plaintiffs must show that (i) the defendants made a misrepresentation or omission of material fact, (ii) with scienter, (iii) upon which the plaintiffs relied, and (iv) that caused damage to the plaintiffs. *Van de Velde v. Coopers & Lybrand*, 899 F. Supp. 731, 734 (D. Mass. 1995). The defendants argue that the amended complaint should be dismissed because (i) there is

no factual basis for the plaintiffs' claims of fraud; (ii) the amended complaint is based only on information and belief and therefore insufficient under the PSLRA; and (iii) there are no facts giving rise to a strong inference that any of the defendants had the necessary scienter. Memorandum of Law In Support of Defendants' Motion to Dismiss the Amended Class Action Complaint ("Defendants' Memorandum"), attached to Motion to Dismiss the Amended Class Action Complaint (Docket No. 14), at 3-4. The defendants also argue, without citation to authority, that the PSLRA has changed the requirement of Rule 12(b)(6) so that allegations made on information and belief in a complaint initiating a private action alleging securities fraud should not be assumed to be true for purposes of evaluating a motion to dismiss. *Id*. at 3 n.1. The plaintiffs, relying primarily on reported case law in which the decisions were issued before the PSLRA took effect, respond that the standards of Rule 12(b)(6) remain unchanged and that the PSLRA merely codified existing case law interpreting Rule 9(b) with respect to securities litigation. Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Dismiss the Amended Class Action Complaint ("Plaintiffs' Opposition") (Docket No. 17) at 5-6. When viewed in this light, they contend, the amended complaint contains sufficient factual allegations to withstand a motion to dismiss.

The applicable sections of the PSLRA provide as follows:

> **(b) Requirements for securities fraud actions**
>
> **(1) Misleading statements and omissions**
>
> In any private action arising under this chapter in which the plaintiff alleges that the defendant —
>
> **(A)** made an untrue statement of a material fact; or
>
> **(B)** omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading,

> the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.
>
> **(2) Required state of mind**
>
> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u-4(b)(1)-(2).

The required state of mind depends on the type of statement allegedly made. If the allegedly false or misleading statement is forward-looking, a plaintiff must be able to prove that the defendant had actual knowledge that the statement was false or misleading when made. 15 U.S.C. § 78u-5(c)(1)(B). A forward-looking statement is defined as

> **(A)** a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
> **(B)** a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
> **(C)** a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the [SEC];
> **(D)** any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
> **(E)** any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
> **(F)** a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the [SEC].

15 U.S.C. § 78u-5(i)(1). If a statement is not forward-looking, the courts whose decisions are

reported differ as to pleading requirements. Some require the plaintiff to plead facts giving rise to a strong inference of recklessness, either by demonstrating that the defendant had the motive and opportunity to commit fraud or by alleging specific facts constituting circumstantial evidence of conscious behavior or recklessness. *E.g.*, *Shields*, 25 F.3d at 1130. Other courts have rejected the "motive and opportunity" alternative, holding that the PSLRA has eliminated it in favor of the more stringent alternative pleading requirement. *E.g.*, *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 756-57 (N.D.Cal. 1997); *In re Baesa Sec. Litig.*, 969 F. Supp. 238, 242 (S.D.N.Y. 1997). In any event, the First Circuit has specifically declined to review or adopt the "motive and opportunity" test set out by the Second Circuit in *Shields*. *Maldonado v. Dominguez*, 137 F.3d 1, 10 n.6 (1st Cir. 1998) (First Circuit will use its own previously-developed framework for analyzing sufficiency of pleadings in securities cases).

To meet the requirement to show justifiable reliance on the defendants' alleged omissions or misrepresentations, the plaintiffs rely in part on the "fraud-on-the-market doctrine," the premise of which is that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Basic Inc. v. Levinson*, 485 U.S. 224, 246 (1988).

The amended complaint asserts two claims: one raised under Section 10(b) (15 U.S.C. § 78j(b)) against all defendants and one raised under Section 20(a) (15 U.S.C. § 78t(a)) against the individual defendants.

A. The Section 10(b) Claim

The primary element of a claim under section 10(b) and the accompanying Rule 10b-5 is a showing that the defendant made materially misleading statements or omissions. *Basic*, 485 U.S. at

230-31. A false statement or omission is considered material if its disclosure would alter the total mix of facts available to an investor and "if there is a substantial likelihood that a reasonable shareholder would consider it important" to the decision to invest. *Id*. at 231. "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Id*. at 239 n.17. Scienter is "a mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

The plaintiffs do not contend that the amended complaint is based on anything other than information and belief. Under such circumstances, the First Circuit requires that both "the source of the information and the reasons for the belief" be laid out in the complaint. *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991). Not only must the time, place and content of the alleged misrepresentations be alleged, but the complaint must also contain

> factual allegations that would support a reasonable inference that adverse circumstances existed at the time (the statement or representation was made), and were known and deliberately or recklessly disregarded by defendants.

Id. The plaintiffs vigorously argue that they need not disclose the sources of the information that provides the basis for their claims so long as the amended complaint states with particularity the facts upon which the claims are based. Plaintiffs' Opposition at 12-14. They base this argument on the language of the PSLRA, which states that when allegations are made on information and belief, "the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1).

While *Romani* predates the enactment of the PSLRA, the language upon which the plaintiffs rely is not inconsistent with *Romani*'s requirement that the complaint set forth both the source of the information and the reasons for the belief. *See Novak v. Kasaks*, 997 F. Supp. 425, 431 (S.D.N.Y. 1998) ("If, in fact, these unnamed 'consultants' provided information forming the basis for these

allegations, then the consultants should have been named in the complaint.") The fact that the First Circuit in *Romani* found no allegations of fact concerning either source or reasons for all but one of the plaintiff's claims, *id*. at 879, does not transform this single, two-part requirement into two alternative requirements, as the plaintiffs appear to contend. Plaintiffs' Opposition at 13-14. The intent of the PSLRA was to make the pleading requirements for private actions alleging securities violations more stringent than those imposed by Rule 9(b), not less so. *Powers v. Eichen*, 977 F. Supp. 1031, 1038 (S.D.Cal. 1997). Accordingly, where it is relevant I will discuss the presence or absence of reference to a source for the claims set forth in the amended complaint.

1. Duty to Disclose

The defendants begin their substantive argument with the assertion that they had no duty to disclose the information which the complaint alleges they failed to disclose. "The corporation must first have a duty to disclose the nonpublic material information before the potential for any liability under the securities laws emerges." *Gross v. Summa Four, Inc.*, 93 F.3d 987, 992 (1st Cir. 1996). "[A] corporation does not commit securities fraud merely by failing to disclose all nonpublic material information in its possession." *Id*. A duty to disclose "may arise if, *inter alia*, a corporation has previously made a statement of material fact that is either false, inaccurate, incomplete, or misleading in light of the undisclosed information." *Id*. The plaintiffs rely on *Roeder v. Alpha Indus., Inc.*, 814 F.2d 22 (1st Cir. 1987), to support their argument in response that a duty to disclose the information at issue here arose because corporate insiders traded securities and a statute or regulation required disclosure, in addition to the situation set forth in *Gross*. Plaintiffs' Opposition at 24. The defendants contend that the language in *Roeder* upon which the plaintiffs rely has been limited by the First Circuit in *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194 (1st Cir. 1996).

The amended complaint does allege that the individual defendants and other IDEXX directors who had access to confidential information and were aware of the truth about the company and its products sold IDEXX shares during the class period. Amended Complaint ¶ 100. However, the plaintiffs do not indicate how these sales by insiders gave rise to a duty that extended to the plaintiffs and the proposed class concerning the specific information at issue. Plaintiffs' Opposition at 24-25. In the absence of developed argumentation on this point, the court need not consider it further.[2] *Collins v. Marina-Martinez*, 894 F.2d 474, 481 n.9 (1st Cir. 1990); *Hanlin Group, Inc. v. International Minerals & Chem. Corp.*, 759 F. Supp. 925, 931 (D. Me. 1990).

The plaintiffs focus their argument concerning the duty to disclose on the defendants' alleged violation of Item 303 of Regulation S-K, 17 C.F.R. § 229.303(a).[3] Plaintiffs' Opposition at 24-25. The defendants take the position that Section 10(b) does not impose any duty on them to comply with Item 303 because there is no private right of action under Item 303. Defendants' Memorandum at 8. The First Circuit has eschewed any intent to create a private right of action under Section 10(b) for violations of any SEC rule. *Shaw*, 82 F.3d at 1222 n.37. The plaintiffs contend that the First Circuit

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[2] If the issue had been appropriately presented, I would find persuasive the holding in *Simon v. American Power Conversion Corp.*, 945 F. Supp. 416, 425 (D. R. I. 1996) (and cases cited therein), that insider trading by individuals does not trigger a duty to disclose on the part of the corporation.

[3] The regulation requires corporations filing forms with the SEC pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, among others, to "[i]dentify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way," to "[d]escribe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations," and to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(1) & (3)(i) & (ii).

in *Shaw* held that a duty to disclose may be derived from an SEC regulation, Plaintiffs' Opposition at 25 n.30, but *Shaw* limits its finding of such a duty to the context of a prospectus filed with a public offering, 82 F.3d at 1202, a factual situation quite distinct from that presented here. Several courts have held directly that a violation of an SEC rule may not establish a duty to disclose for purposes of a claim under Section 10(b). *E.g.*, *Freedman v. Louisiana-Pac. Corp.*, 922 F. Supp. 377, 390 (D. Or. 1996); *In re Caere Corp. Sec. Litig.*, 837 F. Supp. 1054, 1061 n.4 (N.D.Cal. 1993). The plaintiffs cite no case law to the contrary. I find the holding of these courts to be persuasive. The plaintiffs must therefore look to a statement previously made by the defendants as the source of the alleged duty to disclose the information at issue.

The defendants devote considerable effort to arguing that they had no duty to make projections or to disclose mismanagement under the circumstances set forth in the amended complaint. Defendants' Memorandum at 6-11. The plaintiffs reply that they do not contend that the defendants failed to make projections, Plaintiffs' Opposition at 24, so the court need not consider that issue. The plaintiffs further respond, in summary fashion, that their factual allegations are not properly characterized as claims of mismanagement. *Id*. at 25-26. In *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-79 (1977), the Supreme Court held that internal corporate mismanagement is not within the scope of section 10(b). The defendants interpret paragraphs 14-44 and 66 of the amended complaint as alleging mismanagement. The plaintiffs characterize those paragraphs as claims of specific misrepresentation and material nondisclosure actionable under section 10(b), citing *In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 927 (9th Cir. 1993), and *Gross v. Medaphis Corp.*, 977 F. Supp. 1463, 1473 (N.D.Ga. 1997).

Assuming *arguendo* that the allegations set forth in the amended complaint reach beyond

corporate mismanagement, it is still necessary that the amended complaint allege sufficiently that the information at issue was material and that it was withheld with the necessary scienter. The defendants argue that the amended complaint fails to set forth a sufficient factual basis for the assertion that the challenged statements were materially false. Defendants' Memorandum at 11. The plaintiffs respond that materiality is an issue inappropriate for resolution via a motion to dismiss, citing *Basic*, 485 U.S at 236. Plaintiffs' Opposition at 11-12. The question whether allegations in a complaint are sufficiently pleaded to state a claim, however, addresses a matter that is separate and distinguishable from the question whether those allegations, once they have been found sufficient, have been proved in accordance with the applicable legal standard. It is the latter question that is reserved for the factfinder at trial. *See Lucia v. Prospect St. High Income Portfolio, Inc.*, 36 F.3d 170, 176 (1st Cir. 1994) (summary judgment). In addition, the First Circuit has noted the "[r]eview of vaguely optimistic statements for immateriality as a matter of law may be especially robust in cases involving a fraud-on-the-market theory of liability," *Shaw*, 82 F.3d at 1218, as is the case here.

2. Revenue Statements

The defendants first address allegations in paragraphs 25, 44, 49, 52 and 53 of the amended complaint as inactionable because the statements from the quarterly earnings announcements identified in those paragraphs are accurate presentations of past results. The First Circuit has "consistently held that the fact that a company makes an affirmative true statement about past results does not give rise to a duty to comment on its current status." *Gross*, 93 F.3d at 994 (accurate statement that company had received significant orders from certain customers not materially misleading due to facts that company was also experiencing delays in consummating contracts for at least one of these orders, in receiving other orders, and in shipping products; issue presented in

context of motion to dismiss). The plaintiffs respond that the statements at issue are not statements of historical fact but rather statements describing a trend in IDEXX's business, and therefore subject to a different standard. Plaintiffs' Opposition at 8 n.10.

Of the five paragraphs addressed by the defendants in this section of their motion, three — numbers 44, 49 and 52 — are sufficiently similar to be discussed together. Paragraph 53 concerns statements allegedly made to securities analysts and will be discussed later, along with other paragraphs in the amended complaint that raise similar charges. Paragraph 25 sets forth events that occurred after the class period and does not, in itself, set forth an allegedly false and misleading statement. Each of the remaining three paragraphs sets forth the figures stated in an IDEXX press release for the second, third and fourth quarters, respectively, of 1996 for revenue and net income for the quarter, as compared to the same quarters in the previous year, and for the year to date. The only other statements singled out by the amended complaint from the press releases follow:

> The increase in revenues for the quarter compared to the prior year is primarily attributable to increased sales of the veterinary clinical chemistry and hematology product lines, test kits for feline viruses, and veterinary laboratory services. (¶ 44)
>
> The increase in revenues for the quarter compared to the prior year is primarily attributable to increased sales of veterinary laboratory services resulting from recent acquisitions of veterinary laboratories, veterinary clinical chemistry consumable [sic], and test kits for canine heartworm. (¶ 49)
>
> The increase in revenues in 1996 compared to 1995 is primarily attributable to increased sales of veterinary clinical chemistry consumable [sic], veterinary laboratory services resulting from acquisitions of veterinary reference laboratories, canine test products, and a quantitative thyroid instrument introduced in the first quarter of 1996. (¶ 52)

In each case, the words "increased sales" are emphasized in the amended complaint. Each paragraph also alleges that "[t]hese statements and reported financial results were materially false and misleading

for the reasons stated in ¶ 64."

Paragraph 64 of the amended complaint lists 17 reasons why "[e]ach of the positive statements" mentioned in the cited paragraphs, among others, "was materially false and misleading when issued, and failed to disclose . . . the following adverse information." Not all of the 17 items appear to apply to the three cited paragraphs, however, and none of them suggests that any of the actual numbers reported by IDEXX was in fact inaccurate. Paragraph 64 focuses on reasons why the statement in each of the cited paragraphs that increased sales were the cause for an increase in reported revenue over that for the same period in the prior year was allegedly inaccurate. The possibly applicable reasons or "adverse information" set forth in Paragraph 64 include: (i) IDEXX failed to disclose that the increased sales were the result of loading products onto distributors, granting lenient payment terms and providing expansive rights of return, credit, or substitution (¶ 64(a)); (ii) IDEXX failed to disclose that it "dumped unneeded and unwanted products on its distributors in amounts that far exceeded clinical sales (or any reasonable prospects for clinical sales)" (¶ 64(b)); (iii) IDEXX failed to disclose that its distributors' inventories were "extremely bloated," making distributors increasingly reluctant to accept additional product (¶ 64(c)); (iv) substantial amounts of short-dated product was in IDEXX's distribution channels (¶ 64(d)); (v) a significant amount of the sales reported by IDEXX should not have been recognized as revenue (¶ 64(f)); (vi) IDEXX failed to disclose that its canine allergy test product was sold prematurely and was being returned and exchanged for canine heartworm test kits (¶ 64(k)-(l)); and (vii) IDEXX had to slash the price of its feline leukemia test kit in France (¶ 64(m)).

In their opposition, the plaintiffs identify only the "increased sales" statements as being false, and argue that, even if they were true, they are nonetheless actionable because, in context, they misled

investors as to the financial condition and performance of IDEXX, citing *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990). Plaintiffs' Opposition at 7-12 & nn.10-11. However, the explanation given by the plaintiffs as to why the statements were misleading is not significantly different from the circumstance in *Gross* where the misleading nature of the statement at issue was asserted to be unstated facts that would have an effect in the future of causing a decrease in revenue. It also seems clear that the challenged statements at issue in paragraphs 44, 49 and 52 of the amended complaint are facially accurate statements concerning past performance and not descriptions of trends, as the plaintiffs contend. Under *Gross*, therefore, the statements do not appear to be actionable.[4] Accordingly, it is unnecessary to address the parties' dispute concerning the practice of "loading," also known as "channel stuffing." *See, e.g., Harvey M. Jasper Retirement Trust v. Ivax Corp.*, 920 F. Supp. 1260, 1266 (S.D.Fla. 1995). The defendants are entitled to dismissal of the claims raised in paragraphs 44, 49 and 52 of the amended complaint.

3. Allegations Involving GAAP

The defendants next challenge the amended complaint's allegations that IDEXX's accounting practices violated GAAP, specifically paragraphs 71-73, 76-79 and 83-85. Defendant's Memorandum at 13-16. The plaintiffs respond that IDEXX violated GAAP by (i) improperly recognizing revenue in connection with sales of a canine allergy test kit [presumably ¶¶ 71-72 of the amended complaint];

[4] The defendants contend that paragraphs 45, 48, 50 and 51 of the amended complaint also raise only allegations of "loading" and should be dismissed for the same reason as paragraphs 44, 49 and 52. Defendants' Memorandum at 12 & n.20. Paragraphs 48 and 51 do not allege "loading" and are not subject to the same analysis as are paragraphs 44, 49 and 52. Paragraphs 45 and 50, however, do, in part, make essentially the same "loading" allegations with respect to Forms 10-Q filed by IDEXX, presumably with the SEC, for the second and third quarters of 1996. To the extent that these paragraphs raise such claims, the defendants are entitled to dismissal for the reasons set forth above. However, both paragraphs also include statements concerning the preparation of IDEXX's financial statements, which will be addressed separately *infra*.

(ii) improperly recognizing revenue "when distributors had been given broad rights of return and Idexx could not reasonably estimate returns" [presumably ¶¶ 76-77]; (iii) improperly recognizing revenues on the sale of veterinary instruments "prior to receiving a firm commitment on the sale" [presumably ¶ 73]; and (iv) failing to establish reserves for returns and impaired inventory [presumably ¶¶ 79-83]. Plaintiffs' Opposition at 9. These violations, the plaintiffs assert, resulted in a material overstatement by IDEXX of its "operating results." *Id.*

The parties rely on case law from jurisdictions other than the First Circuit and its constituent districts to support their positions on this issue.[5] However, the First Circuit's decision in *Gross* directs the outcome here. In that case, the complaint alleged that the defendant's revenue and earnings statements during the class period were materially misleading because the defendant recognized revenue upon receipt of orders rather than upon shipment of product, contrary to GAAP. 93 F.3d at 995. The First Circuit held:

> Though these contentions give us some pause, we nonetheless agree with the district court that Gross failed to plead this claim with sufficient particularity for purposes of Rule 9(b). As we have noted, "a general allegation that the practices at issue resulted in a false report of company earnings is not a sufficiently particular claim of misrepresentation [to satisfy Rule (b)]." *Serabian* [*v. Amoskeag Bank Shares, Inc.*], 24 F.3d [357,] 362 n.5 [1st Cir. 1994)]. In this case, Gross has failed to allege any particulars to support his general allegation of inflated earnings through the use of improper accounting methods. Specifically, he has not alleged the amount of the putative overstatement or the net effect it had on the company's earnings.

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[5] One of the cases upon which the plaintiffs rely, *Cooper v. Pickett*, 137 F.3d 616 (9th Cir. 1997), actually supports the defendants' position. In that case, the court held that the complaint satisfied Rule 9(b) as to its allegations of improper revenue recognition because it identified the specific customers whose transactions gave rise to the claim, alleged the specific amounts by which the defendant had inflated its revenues in specific quarters, and alleged that the defendant had claimed that its revenue recognition policy was stricter than it actually was. *Id*. at 627. The amended complaint here is not nearly so specific or complete.

Id. at 996 (citing cases).

Here, the amended complaint, extending the plaintiffs every reasonable inference in their favor, alleges the amount of the putative overstatement only with respect to the canine allergy tests, "approximately $2 million" in the fourth quarter of 1995 and "approximately $1.5 million" in the first quarter of 1996. Amended Complaint ¶ 66. The only allegation concerning the net effect of either of these alleged overstatements on IDEXX's earnings is that they "artificially inflated Idexx's income before taxes for the six months ended June 30, 1996 by approximately five percent." *Id*. ¶ 72. There are no allegations supporting this conclusion,[6] and no allegations that this inflation of reported income before the class period also rendered materially false and misleading the financial statements identified in the amended complaint as the grounds upon which the plaintiffs seek relief. I accordingly conclude that the amended complaint is not sufficiently particular under *Gross* as to the claims based on allegations of overstatement of revenues in violation of GAAP . The defendants are entitled to dismissal of the claims set forth in paragraphs 65-73, 76-79 and 83-85.

4. Security Analysts' Reports

The defendants move on to the allegations concerning statements made by employees or officers of IDEXX to third parties, Amended Complaint ¶¶ 48, 51 and 53, contending that they are not actionable, Defendants' Memorandum at 18-21, and to challenge the allegations that statements made by securities analysts that are alleged to be false and misleading, Amended Complaint ¶¶ 46, 47, and 54, may be attributed to the defendants, Defendants' Memorandum at 27-29.

[6] The complaint alleges only that IDEXX's total reported revenue was $188,602,000 for 1995 and $267,677,000 for 1996, with reported net incomes of $21,494,000 and $32,640,000 respectively. Amended Complaint ¶ 52. It is therefore impossible to compare the alleged overstatements to the reported revenue for the quarters at issue.

Paragraph 48 of the amended complaint provides:

> On September 18, 1996, Idexx senior management made an upbeat presentation at the DLJ Emerging Growth Conference. At the conference, Idexx emphasized the growth potential of the $200M veterinary diagnostic [sic] and highlighted that market's importance in the Company's revenue growth.

The only assertion that the implied statement by IDEXX set forth in paragraph 48 was materially false and misleading when made is found in paragraph 64. The defendants attack paragraph 48 as insufficient under Rule 9(b). The plaintiffs do not respond beyond a general assertion that, with respect to each statement alleged to be false and misleading, "the speaker and/or source is identified, the precise date of the statement is supplied and the precise public document is identified in which . . . the statement was made." Plaintiffs' Opposition at 7 (referring to ¶¶ 44-54). This argument is not accurate concerning paragraph 48, which identifies no speaker and no document and presents no statement as such. To the extent that paragraph 48 is intended to establish a false or misleading statement upon which the plaintiffs may seek recovery, it does not meet the requirements of Rule 9(b) and the defendants are entitled to dismissal of any such claim.

Paragraph 51 of the amended complaint provides:

> On November 14, 1996, Idexx held a conference call with analysts in which it reported that its fourth quarter 1996 financial results would fall slightly below analysts' expectations due to an unexpected increase in legal fees relating to pending patent litigation. In response, analysts lowered their estimates of Idexx's financial performance for the fourth quarter of 1996. Reuters reported that defendant Shaw thought that a $0.02 per share earnings estimate reduction was "conservative." These statements were materially false and misleading for the reasons stated in ¶ 64.

The defendants challenge this paragraph under Rule 9(b) because it does not identify a particular speaker, it paraphrases rather than directly quotes an alleged statement, the statement addresses earnings rather than revenues and a press release issued by IDEXX the same day "states clearly that

it was too early in the quarter to predict revenues." Defendants' Memorandum at 19-20. The plaintiffs again provide no response to this argument beyond the general statement from page 7 of their opposition quoted above. Because the motion before the court is one to dismiss, and the November 14, 1996 press release is not included in the amended complaint, the court may not consider it at this time. None of the case law cited by the defendants requires that the verbatim statement, rather than a statement conveying its substance, be provided in order to satisfy Rule 9(b). The amended complaint does not limit its allegations to securities fraud involving statements of revenue, but also includes such allegations involving statements of earnings. Accordingly, the only remaining challenge to paragraph 51 among those raised by the defendants is the fact that the speaker of the allegedly false or misleading statement in the first sentence is not identified. While the First Circuit does require that the speaker of a challenged statement be identified, *Suna*, 107 F.3d at 68, to the extent that the plaintiffs seek to hold IDEXX, rather than one of the individual defendants, liable for the statement, I conclude that paragraph 51 is not subject to dismissal for any of the reasons argued by the defendants.

Paragraph 53 of the amended complaint provides:

> On March 13, 1997, Idexx senior management held a conference call with analysts and instructed them to cut their earnings estimates for 1997. Idexx senior management also told analysts:
>
> - that they expected Idexx to earn $1.15 for 1997; and
> - that Idexx's earnings-per-share growth rate was in the 35-40% range as was the Company's revenues growth rate.
>
> These statements were materially false and misleading for the reasons stated in ¶ 64.

The defendants again assert that this paragraph is insufficient under Rule 9(b) because it does not identify a specific speaker and "characterizes" rather than directly quotes the statement at issue.

Defendants' Memorandum at 20-21. These arguments fail for the reasons previously stated. The defendants also contend that the amended complaint fails to allege that IDEXX's senior management did not believe that the statement was accurate when made, eleven days before the end of the class period, and that the statement is merely one concerning historic reality. *Id.* The latter argument fails on its face; the statement set forth is clearly forward-looking. Paragraph 64 of the amended complaint, to which paragraph 53 refers, taken in its entirety and with inferences drawn in favor of the plaintiffs, provides a factual basis upon which a factfinder could conclude that the defendants knew at the time the statement was made that it was materially false or misleading. The defendants are not entitled to dismissal of claims based on paragraph 53 of the amended complaint for the reasons stated in their argument on pages 18-20 of their memorandum.

Paragraphs 46, 47 and 54 of the amended complaint set forth statements made by Cowen & Co. on August 16, 1996 and March 19, 1997; Bear Stearns on September 13, 1996; and Lehman Brothers on March 17, 1997. Two of these firms are identified as "securities firms" in the amended complaint. Amended Complaint ¶ 89. Paragraph 51 refers to unidentified "analysts" who "lowered their estimates of Idexx's financial performance for the fourth quarter of 1996." The defendants contend both that they cannot be held liable for these statements and that the amended complaint, including related allegations in paragraphs 88-94, fails to meet the particularity requirements of Rule 9(b) as to such allegations. Defendants' Memorandum at 27-29. The First Circuit "has not yet decided whether statements in an analyst's report may be attributable to a defendant company." *Suna*, 107 F.3d at 73. In *Suna*, the First Circuit assumed that such statements would be so attributable under the conditions set forth in *Elkind v. Liggett & Myers, Inc*., 635 F.2d 156, 163 (2d Cir. 1980), and proceeded to consider whether the plaintiffs had met Rule 9(b)'s pleading requirements for such a

claim. *Suna*, 107 F.3d at 73. Finding that the plaintiffs had not done so, the First Circuit did not need to reach the initial question. *Id.* I will employ a similar methodology here.

The general information included in paragraphs 88-94 concerning contact between the defendants and securities analysts is insufficient under Rule 9(b). Indeed, the language in paragraph 92 is strikingly similar to that rejected under Rule 9(b) by the First Circuit in *Suna*. 107 F.3d at 73. Paragraphs 46, 47, 53 and 54 therefore remain for review concerning the reports of securities analysts. Some courts appear to have held that a corporate defendant may be liable for statements made by securities analysts when it undertakes to pass on earnings forecasts through analysts' reports and those forecasts include materially misleading facts or omissions. *E.g., Alfus v. Pyramid Tech. Corp.*, 764 F. Supp. 598, 603 (N.D.Cal. 1991); *see Elkind*, 635 F.2d at 164. Others have required evidence that corporate or individual defendants adopted the analyst's forecast. *E.g., In re Caere Corp. Sec. Litig*., 837 F. Supp. at 1059 (individual "insider" defendant, citing *Elkind*). *See also Zeid v. Kimberley*, 973 F. Supp. 910, 919 (N.D.Cal. 1997); *Schaffer v. Timberland Co*., 924 F. Supp. 1298, 1310 (D.N.H. 1996) (requiring express or implied adoption of analyst's statement, placing of imprimatur on analyst's statement, or other entanglement with analysts "to a significant degree").

Here, the plaintiffs allege adoption only in the instance set forth in paragraph 47 of the amended complaint, consisting of the Bear Stearns report on September 13, 1996 that defendant Shaw "Announced He Was Very Comfortable with 1996 and 1997 Estimates," and "We Are Looking For $275MM In Sales And $0.83 EPS in 1996 AND $370MM In Sales And $1.22 EPS In 1997." Plaintiffs' Opposition at 28. Paragraph 47 alleges that the report "was based on detailed guidance from defendants." The plaintiffs rely on *In re Burlington Coat Factory Sec. Litig*., 114 F.3d 1410, 1429 (3d Cir. 1997), to support their argument that Shaw's statement that he was "very comfortable"

with the estimates means that he adopted the estimates and endorsed them as reasonable. It is far from clear that the "1996 and 1997 estimates" allegedly adopted by Shaw and presumably false or materially misleading are the numbers set forth in the following sentence quoted in paragraph 47. Even if the plaintiffs are given the benefit of a plausible inference to that effect, I find persuasive the Fourth Circuit's decision in *Malone v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir. 1994), that a statement of "comfort" with an analyst's predictions cannot be deemed actionable unless the statement is supported by specific statements of fact or worded as a guarantee.

In *Burlington Coat* the Third Circuit, while allowing that such a statement may be actionable, required the plaintiff to allege facts sufficient to permit a reasonable inference that the forecast was made "with either (1) an inadequate consideration of the available data or (2) the use of unsound forecasting methodology." 114 F.3d at 1429. The Third Circuit then concluded that an allegation that the defendant who expressed comfort with the forecast had no reasonable basis to state that the company would earn the forecasted amount was insufficient under Rule 9(b). *Id.* at 1430. Here, the plaintiffs make no allegations concerning the forecasting methodology used to generate the figures included in the forecast quoted in paragraph 47. The amended complaint might state a claim in this paragraph under the first *Burlington Coat* alternative were it not for the fact that the amended complaint must also sufficiently allege scienter as to this forward-looking statement. 15 U.S.C. § 78u-5(c)(1)(B) ("safe harbor" provision).[7] The sufficiency of the pleadings with respect to scienter will be

[7] The plaintiffs' assertion that the "safe harbor" provision is inapplicable because the statement at issue was not accompanied by "meaningful cautionary language," Plaintiffs' Opposition at 28 n.33, is incorrect. The "safe harbor" statute provides protection for forward-looking statements that are immaterial or accompanied by meaningful cautionary statements, *or* when the plaintiff fails to prove that such statements were made with scienter. 15 U.S.C. § 78u-5(c). The defendants invoke the latter form of protection, which is available regardless of the presence or absence of (continued...)

discussed below. In any event, the defendants are entitled to dismissal of the claim of adoption raised in paragraph 47 of the amended complaint for the reasons set forth in *Malone*.

The remaining paragraphs of the amended complaint dealing with analysts' reports rely on the theory that "defendants made materially false and misleading representations to securities analysts who, in turn, conveyed these deceptive representations to the marketplace." Plaintiffs' Opposition at 27. Paragraph 46 of the amended complaint provides:

> On August 16, 1996, Cowen & Co. issued an analyst report which stated that they had visited Idexx on August 15, 1996, and that Idexx management had assured them that the Company was growing at a fast rate:
>
> > Business prospects continue to be very upbeat, revenue and earnings visibility remains very high. Reaffirming 35-40% growth prospects following company visit.

This paragraph simply does not identify statements made by any of the defendants that were allegedly false or misleading. *Suna*, 107 F.3d at 74. In addition, it cannot be determined from the amended complaint whether the statements presented as a quotation from the analyst report were quoting statements of any of the defendants or were direct statements by the analyst. *See Raab v. General Physics Corp.*, 4 F.3d 286, 288-89 (4th Cir. 1993) (failure to allege with specificity who supplied information to analyst, how it was supplied, or how company could have controlled content of statement constitutes failure to plead facts from which inference supporting liability may be drawn). In addition, an assurance "that the Company was growing at a fast rate," if construed as a historical statement, appears to be true, based on the information provided in the amended complaint. If it is construed as a statement concerning future performance, it appears to be precisely the sort of "vaguely

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[7](...continued)
cautionary language in the statement at issue. *Medaphis*, 977 F. Supp. at 1473.

optimistic statement" disfavored as a basis for liability in *Shaw*. 82 F.3d at 1218. The defendants are entitled to dismissal of claims based on paragraph 46 of the amended complaint.

Paragraphs 53 and 54 of the amended complaint, on the other hand, when considered together appear to meet the requirements of Rule 9(b) for a claim arising from analysts' reports, again assuming that scienter is adequately alleged so that the "safe harbor" exception does not apply to the forward-looking statements attributed to IDEXX senior management[8] in paragraph 53. It is necessary, therefore, to predict what the First Circuit would do when faced with a claim that a violation of section 10(b) has occurred by attribution of a statement in an analyst's report to the company or one or more of its unnamed officers. Given the First Circuit's reluctance in *Suna* to reject such a claim out of hand, I conclude that it is more likely that such a claim would be allowed to proceed in this circuit. Accordingly, the plaintiffs should be allowed to proceed with claims arising from paragraphs 53 and 54, provided that scienter is adequately alleged.

5. Scienter

The PSLRA establishes a standard for pleading scienter. The complaint must state with particularity, with respect to each act or omission alleged to violate federal securities statutes, facts giving rise to a strong inference that the defendant acted with the required state of mind. 15 U.S.C. § 78u-4(b)(2). The First Circuit interprets this requirement to be consistent with the standard that it has historically applied. *Maldonado*, 137 F.2d at 9 n.5. The complaint must "set[] forth specific facts

[8] To the extent that the defendants argue that the complaint must reflect attribution of each allegedly misleading or false statement to a specifically identified individual, rather than to "IDEXX senior management," that degree of specificity is not required. *See, e.g., Schaffer*, 924 F. Supp. at 1311-12 (finding sufficient allegations, *inter alia*, that "management stated on the call that [the corporate defendant's] earnings for 1994 would be $3.00 or more per share" and that "members of [defendant corporation] management . . . told [the analyst] . . . that fourth quarter sales growth would be higher").

that make it reasonable to believe that defendant knew that a statement was false or misleading." *Id*. at 9, quoting *Greenstone v. Cambex Corp*., 975 F.2d 22, 25 (1st Cir. 1992). "Even if plaintiffs wish to prove scienter by 'recklessness,' they still must allege, with sufficient particularity, that defendants had full knowledge of the dangers of their course of action and chose not to disclose those dangers to investors." *Id.* n.4. The First Circuit has specifically declined to adopt the Second Circuit's "motive and opportunity" test for scienter in this context. *Id*. at 10 n.6. The plaintiffs' discussion of their amended complaint in terms of evidence of motive and opportunity, Plaintiffs' Opposition at 19-21, is therefore of little value here.

The defendants argue that the amended complaint fails to provide a factual basis for a strong inference of scienter, whether through the alleged GAAP violations, knowledge of rising inventories, sale of the canine allergy test kit that sometimes gave false results, or insider stock sales. Defendants' Memorandum at 22-27. The plaintiffs respond that a complaint need only allege "a minimal factual basis" for a finding of scienter, citing *Cohen v. Koenig*, 25 F.3d 1168, 1173 (2d Cir. 1994), and that the amended complaint meets this standard by pleading "ample facts from which defendants' knowing or reckless misconduct can be inferred," Plaintiffs' Opposition at 16, including each of the specific bases listed above and "the totality of the facts alleged in the Complaint when viewed in a light most favorable to plaintiff," *id*. at 19.[9] The plaintiffs' reliance on *Cohen* is misplaced. Governing First

[9] The plaintiffs offer their allegations that the defendants inflated the price of IDEXX stock "in order to complete the acquisition of Idetek Inc.," Amended Complaint ¶ 97, and that the individual defendants engaged in "substantial" sales of their IDEXX stock during the class period, *id*. ¶¶ 99-100, only to support their argument that the amended complaint sufficiently alleges motive and opportunity as evidence of scienter, Plaintiffs' Opposition at 19-21. Motive and opportunity is not the applicable standard in the First Circuit, as noted above. If paragraph 98 of the amended complaint is also offered to establish scienter, I conclude that it fails to meet the pleading requirements of Rule 9(b).

Circuit precedent, quoted above, clearly requires more than the pleading of a minimal factual basis for scienter in order to avoid dismissal of complaints based on alleged securities fraud. *E.g., Suna*, 107 F.3d at 68 (plaintiff must allege specific facts that make it reasonable to believe that defendant knew that statement was materially false or misleading, even when fraud relates to matters peculiarly within knowledge of opposing party).

In light of my earlier analysis and conclusions, the claims asserted in the amended complaint under section 10(b) that remain for discussion are those raised in paragraphs 51, 53 and 54 dealing with statements made by the defendants to securities analysts and statements published by these analysts. The arguments concerning scienter will accordingly be considered only in connection with these allegations.

The plaintiffs argue that the "aggressive and improper sales practices" alleged in paragraphs 14-43 of the amended complaint constitute facts supporting scienter because such matters "were at the core of Idexx's operations." Plaintiffs' Opposition at 16. However, there are no factual allegations in the amended complaint that make it reasonable to infer that such matters were "core operations" as that term is used in *Epstein v. Itron, Inc.*, 993 F. Supp. 1314, 1326 (E.D.Wash. 1998), the authority upon which the plaintiffs rely for this argument. While the amended complaint does allege that "veterinary diagnostic consumable products" provide a "substantial majority" of IDEXX's revenues and that more than 70% of the company's total revenue in 1995, the year before the year in which the class period began, "was derived from the sale of consumable products," Amended Complaint ¶ 8, there is no allegation of the magnitude of the effect of the challenged sales practices in each of the quarters for which the press releases and 10-K forms are alleged to have included false and misleading reports of revenue. The only specific numbers alleged are an "inventory bloat" of "a staggering $15

million," apparently at the end of the class period, *id*. ¶ 13; an "inventory bulge of $6.8 million in slides" as of November 1996, *id*. ¶ 24; improper recognition of revenue from sales of the canine allergy test kits of $2 million in the fourth quarter of 1995 and $1-1.5 million in the first quarter of 1996, *id*. ¶¶ 66, 71, both quarters before the class period began; and that the improper recognition of the allergy test kit revenue "artificially inflated Idexx's income before taxes for the six months ended June 30, 1996 by approximately five percent," *id*. ¶ 72, again before the class period began. Given the total revenues reported by IDEXX for 1995 and 1996 as set forth in the amended complaint at paragraph 52 ($188.6 million for 1995 and $267.7 million for 1996), these allegations are insufficient to establish that the alleged misrepresentations were "critical to [the defendant's] core operations." *Epstein*, 993 F. Supp. at 1326. A conclusory allegation that "a material amount of instrument sales" was improperly recorded, Amended Complaint ¶ 73, is not sufficient.

The plaintiffs also contend that the allegations in paragraphs 23 and 24 are sufficient to allege scienter. Plaintiffs' Opposition at 17-18. With one exception, the facts alleged in those paragraphs show that the defendants had knowledge of the state of their distributors' inventory, but do not provide any factual support for the allegation that the state of that inventory made the defendants' statements concerning corporate revenues during the class period false or misleading. The exception is the allegation in paragraph 24 that defendant Workman pressured a particular distributor to take $11 million in products that it did not want in the fourth quarter of 1996. An inference could be drawn from the distributor's reluctance that it was unlikely to be able to sell this inventory, that the products would be returned to IDEXX, and that Workman knew that this would happen. The magnitude of this "sale," given the report of $74,565,000 in revenue for that quarter, Amended Complaint ¶ 52, does suggest that the alleged misrepresentation was significant. This allegation also provides some support

for the inference that the defendants knew that the prospective earnings for 1997 that they presented to analysts on March 13, 1997, *id.* ¶ 53, were not correct, an inference that can also be drawn from the defendants' announcement 11 days later that earnings for the first quarter of 1997 would be $.02 to $.05 per share, in contrast to the $1.15 per share for the year that they had predicted on March 13. *See Shaw*, 82 F.3d at 1224-25 (short time frame between allegedly fraudulent statement or omission and later disclosure of inconsistent information may be considered with other facts in determining whether complaint pleads adequate basis for inferring defendants' culpable knowledge).

The plaintiffs argue that their allegations of GAAP violations, standing alone, are sufficient to plead scienter. However, that is not the case in the First Circuit. *Serabian*, 24 F.3d at 362.[10] *See also In re Software Toolworks Inc. Sec. Litig.*, 50 F.3d 615, 627 (9th Cir. 1994-95). The First Circuit has not addressed the question whether GAAP violations may be considered together with other factual allegations in order to determine whether a complaint pleads an adequate basis for scienter. In any event, the GAAP violations alleged in paragraphs 71-73, 76-79 and 83-85 of the amended complaint are not sufficiently related to the statements in paragraphs 51, 53 and 54, either in time or in substance, to support a claim of scienter as to the events set forth in those paragraphs.

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[10] The defendants contend that no inference of scienter may be drawn from "IDEXX's 1995 and 1996 financial statements" because "Arthur Andersen certified them as complete and accurate." Defendants' Memorandum at 23. The memorandum cites "IDEXX's 1996 Form 10-K at 25." *Id.* This document is presumably Item E in the Appendix to Defendants' Memorandum of Law in Support of Defendants' Motion to Dismiss the Amended Class Action Complaint, submitted with Defendants' Memorandum. That document is neither attached to nor expressly incorporated in the complaint and therefore may not be considered in connection with a motion to dismiss. *Cooperativa de Ahorro y Credito Aguada v. Kidder, Peabody & Co.*, 993 F.2d 269, 272 (1st Cir. 1993). Of course, that document does not address 1995 at all. The defendants' argument that the "numbers" included in the "financials" for the last two quarters of 1996 that are mentioned in the complaint as containing false or misleading statements are "part of the 1996 year-end financial statement Arthur Andersen certified," Defendants' Reply at 12 n.18, does not transform the quarterly reports at issue into documents certified by the accountants.

Although it is not argued by the plaintiffs, the First Circuit has stated that allegations of insider stock sales, if not standing alone, may permit an inference that supports scienter. *Shaw*, 82 F.3d at 1224; *see also Greenstone*, 975 F.2d at 26. The sales must be made in suspicious amounts or at suspicious times. *Shaw*, 82 F.3d at 1224. The allegations set forth in the amended complaint, Amended Complaint ¶ 100, concern insider sales that were made during the class period, clearly a "suspicious time," *id*., although it is not possible to tell whether they were made in "suspicious amounts," because there are no allegations concerning the total holdings of each selling insider or his pattern of sales before or after the class period. *See*, *e.g.*, *In re Discovery Zone Sec. Litig.*, 943 F. Supp. 924, 937 (N.D.Ill. 1996) (two defendants sold over 95% of their holdings); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989) (defendants sold slightly greater number of shares in equal period of time just before class period as they did during class period; insufficient to raise issue of scienter). Nonetheless, the allegations are "at least consistent with" the theory of fraud set forth in paragraphs 51, 53, and 54, and therefore "provide some support against the defendants' motion to dismiss under Rule 9(b)." *Shaw*, 82 F.3d at 1224.

On balance, the amended complaint pleads facts supporting a strong inference of scienter, which in the case of the forward-looking statements set forth in paragraph 53 must be actual knowledge under 15 U.S.C. § 78u-5(c)(1)(B), but only as to paragraphs 51, 53 and 54 of the amended complaint. Accordingly, the defendants are not entitled to dismissal of the allegations raised in those paragraphs.

B. The Section 20(a) Claim

Count II of the amended complaint raises a claim against the individual defendants pursuant

to 15 U.S.C. § 78t(a), also known as section 20(a) of the Securities Act. That statute provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause or action.

The individual defendants contend that the amended complaint fails to state a claim against them because they cannot be liable under section 20(a) as controlling persons when the underlying complaint fails to allege a violation of federal securities law, citing *Suna*, 107 F.3d at 72, and because the amended complaint does not allege that they made any of the statements alleged to have been false or misleading and instead asserts a claim against them based solely on their status. Defendants' Memorandum at 30-31.

The plaintiffs argue in response that their claims against the individual defendants are based on the "group-published information" doctrine, which provides that information contained in "group-published" documents such as corporate financial statements and earnings reports is "presumptively the product of the collective efforts of the company's senior officers and directors," citing *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1254 (10th Cir. 1997), and pointing out that the amended complaint alleges that the individual defendants "participated in the drafting, reviewing and/or approving the misleading statements, releases and reports." Plaintiffs' Opposition at 29. The defendants maintain that use of this doctrine "is plainly impermissible in the First Circuit," citing *Hayduk v. Lanna*, 775 F.2d 441, 444 (1st Cir. 1985). Defendants' Memorandum at 30 n.35.

Because I am recommending that dismissal be denied as to claims raised in certain paragraphs of the amended complaint, the defendants' argument based on an absence of underlying claims under

section 10(b) is moot in the context of my view of the case.

Contrary to the defendants' position, invocation of the group-published document doctrine has not been foreclosed by the First Circuit, at least not prior to the adoption of the PSLRA. *Serabian*, 24 F.3d at 367-68.[11] However, I have concluded that the only allegations of the complaint that remain viable concern information provided to securities analysts and reports published by those analysts. Amended Complaint ¶¶ 51, 53 & 54. None of those paragraphs raises a claim based on a statement included in a group-published document. The doctrine "does not hold individual defendants liable for analysts' reports or oral remarks made by others." *Powers v. Eichen*, 977 F.Supp. at 1040; *In re Network Equip. Techs., Inc. Litig.*, 762 F.Supp. 1359, 1367 (N.D.Cal. 1991). Neither paragraph 51 nor paragraph 53, the only viable paragraphs alleging oral remarks, identifies either of the individual defendants as the maker of the remarks at issue. Accordingly, the individual defendants are entitled to dismissal of the claims against them.

C. Motion for Leave to Amend

The plaintiffs have requested leave to replead "in the event that the Court determines that there are any deficiencies in the Complaint" because "this is the first occasion on which the Court has considered the adequacy of plaintiffs' allegations." Plaintiffs' Objection at 30 n.34. The defendants oppose this request "[b]ecause plaintiffs were granted an extensive period of time in which to research and prepare the Complaint, after the filing of the action." Defendants' Reply at 14. The record reflects that the initial complaint in this action was filed on January 9, 1998 and that the parties stipulated, with

[11] I intimate no opinion as to whether the PSLRA affects the viability of the group-published doctrine. *But see Coates v. Heartland Wireless Comm., Inc.*, ___ F.Supp.2d ___, 1998 WL 770495 at *4 (N.D.Tex. Nov. 2, 1998).

approval of the court, that an amended complaint would be filed no later than 45 days after the entry of an order appointing lead counsel and lead plaintiffs in response to a motion to be filed no later than March 10, 1998. Stipulation and [Proposed] Scheduling Order (Docket No. 3) at 2-3. Such a motion was in fact filed on March 10, 1998, Docket No. 4, and granted by the court on March 26, 1998, Docket No. 8. The plaintiffs subsequently filed a motion for an additional 15 days beyond the stipulated period in which to file their amended complaint, and that motion was granted. Docket No. 10 & endorsement. The amended complaint was filed on May 27, 1998.

It is difficult to discern how the plaintiffs will be able to remedy the defects in the amended complaint that I have noted, and the plaintiffs have already enjoyed a period of almost five months in which to amend their complaint. The fact that they have not had an opportunity to do so with the benefit of the court's evaluation of their efforts does not suggest to me any reason to treat this amended complaint differently from any other amended complaint that might benefit from a second redrafting by plaintiffs' counsel with the benefit of the court's analysis of the deficiencies of a first redrafting. On the showing made here, which significantly includes no demonstration of any proposed changes to the amended complaint that could not have been made earlier, I accordingly recommend that the motion for leave to amend be denied.

IV. Conclusion

For the foregoing reasons, I recommend that the defendants' motion to dismiss be **GRANTED** except as to claims asserted against defendant IDEXX in paragraphs 51, 53 and 54 of the amended complaint, and that the plaintiffs' request, construed as a motion for leave to further amend the complaint, be **DENIED.**

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated this 30th day of December, 1998.

_____

David M. Cohen
United States Magistrate Judge